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In the Supreme Court of the United States

OCTOBER TERM, 1942.

No. .....

WARREN TELEPHONE COMPANY,
Petitioner,

vs.

GUY T. HELVERING,
Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of Warren Telephone Company respectfully shows to this Honorable Court:

A.

SUMMARY STATEMENT OF MATTER INVOLVED.

Petitioner did not distribute to its shareholders any part of its 1936 earnings, and in filing its income tax return for the year 1936 and in determining the surtax on undistributed profits imposed by Section 14* of the Revenue Act

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* "Sec. 14. Surtax on Undistributed Profits.

(a) Definitions.—As used in this title—

(1) The term 'adjusted net income' means the net income minus the sum of—

(A) The normal tax imposed by section 13.
(B) * * *
(C) * * *
(D) * * *

(2) The term 'undistributed net income' means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26(c), relating to contracts restricting dividends."

of 1936, petitioner, under the provisions of Section 26(c)(1) of the Revenue Act of 1936,* took credit in an amount equal to its adjusted net income upon the grounds that the provisions of its indenture and of its charter and stock certificates hereinafter referred to were express written contracts entered into prior to May 1, 1936, expressly dealing with and forbidding the distribution of any dividends for the year 1936.

Petitioner was incorporated under the General Corporation Laws of Ohio on April 13, 1926. (R. 32, 34.) On July 1, 1928, petitioner acquired all the assets of The Warren & Niles Telephone Company in exchange for all of the securities issued by petitioner, and on the same day commenced business. (R. 32.)

On September 24, 1928, petitioner executed and delivered an indenture dated as of May 1, 1928, securing an issue of first mortgage bonds in aggregate principal amount of $800,000. (R. 33, 36.) Article Eight, Sections 6, 9 and 14 of the indenture (R. 37) provided as follows:

"ARTICLE EIGHT.

Particular Covenants of the Company.

The Company hereby covenants and agrees:

* * * * *

Section 6. That it will not declare or pay any dividends on any of its capital stock at any time outstand-

---

* "Sec. 26. Credits of Corporations.

In case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

(a) * * *

(b) * * *

(c) Contracts Restricting Payment of Dividends.—

(1) Prohibition of Payment of Dividends.—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. * * *"

ing except out of net earnings remaining after payment of all fixed charges, and after payment of all accrued installments of interest and sinking fund, if any, and maintenance fund in respect of bonds hereby secured and interest on all other funded and unfunded indebtedness and after proper observance of all the covenants hereof.

* * * * *

Section 9. That it will diligently preserve and maintain all the rights, privileges and franchises to it granted and upon it conferred, and will, * * *.

* * * * *

Section 14. That it will comply with the terms and conditions of any and all leases and contracts whether now existing or owned or hereafter entered into by it; that so long as any bonds are outstanding hereunder it will preserve its corporate organization and its right to transact business in every state in which it owns any property, and will do no act by which it might incur a forfeiture of its corporate existence or its right to so transact business, and that it will comply with all lawful statutes, acts and regulations affecting the Company or the mortgaged property.

* * * * *"

Section 2 of Article Ten of the indenture (R. 38) provided that if the Company defaulted in the due observance or performance of any covenant, condition or agreement of the indenture upon its part to be kept and performed and the same continued for a period of sixty days after written notice thereof from the trustee, then the trustee was authorized to and, upon the written request of the holders of one-fourth of the bonds outstanding, was compelled by written notice to the Company to declare the principal of all bonds secured and then outstanding to be due and payable immediately, and upon such declaration the same became immediately due and payable, giving to the trustee the right to enter and take possession of the mortgaged property, to institute foreclosure proceedings, appoint a receiver, etc. (R. 38, 39.)

Throughout the whole of the year 1936 petitioner had outstanding $800,000 principal amount of first mortgage bonds, and in December, 1936, petitioner requested the consent of the trustee under the indenture to the payment of dividends upon petitioner's preferred shares, to which the trustee replied:

> "Replying to wire, we cannot consent to payment dividends on your preferred stock because of deficit in your surplus account shown by audit report December 31, 1935, which deficit not removed by your estimated earnings this year. Stop. Payment of dividends would constitute violation covenant your trust indenture dated May 1, 1928, Section 6, Article 8." (R. 21, 22.)

Petitioner's articles of incorporation authorized the issuance of 5,000 $100 par preferred shares and 5,000 $100 par common shares, of which, on July 1, 1928, petitioner issued 2,450 preferred and 1,250 common shares, all of which were issued and outstanding throughout the years from July 1, 1928, to and including December 31, 1936. (R. 44.) Petitioner's articles of incorporation (R. 35, 36) and its stock certificates, both preferred and common (R. 44, 49), contained the following express provisions relating to the payment of dividends:

> "1. The holders of preferred stock shall be entitled to receive from and after the issuance thereof when and as declared by the Board of Directors from the surplus or net profits of this corporation, yearly dividends at the rate of 7% per annum and no more, payable quarterly on the first days of January, April, July and October in each year. The dividends on the preferred stock from and after its issuance, shall be cumulative and shall be payable before any dividend on the common stock shall be paid or set apart; so that if in any year dividends amounting to 7% shall not have been paid thereon the deficiency shall be paid or set apart before any dividends shall be paid or set apart for the common stock; the cumulations of dividends upon the preferred stock shall not bear interest.

"2. Subject to the foregoing provisions and not otherwise, such dividends as may be determined by the Board of Directors may be declared and paid on the common stock from time to time out of the remaining surplus or net profits of the company."

At the end of the year 1935 petitioner had a deficit in surplus account of $47,131.49. (R. 33.) Petitioner's taxable net income for the year ended December 31, 1936, is admittedly $29,028.97 (R. 16), an amount insufficient to make up the deficit of $47,131.49 existing December 31, 1935.

The respondent disallowed the credit claimed (R. 7-12) and petitioner appealed to the Board of Tax Appeals. (R. 3.) The Board of Tax Appeals affirmed respondent's finding. (R. 54-59.) Petitioner then filed a petition for review with the United States Circuit Court of Appeals for the Sixth Circuit (R. 74), which Court on June 2, 1942, affirmed the decision of the Board of Tax Appeals. (R. ....; 128 F. 2d 503) and on August 28, 1942, denied petitioner's application for rehearing. (R. ...)

B.

STATEMENT AS TO JURISDICTION.

1. Section 350 of Title 28, U. S. C., provides:

"No right of error, appeal, or writ of certiorari intended to bring any judgment or decree before the Supreme Court for review shall be allowed or entertained unless application therefor be duly made within three months after the entry of such judgment or decree. * * *"

The judgment of the ~~Board of Tax~~ Court of Appeals was filed June 2, 1942. (R. 84.) On June 30, 1942 (R. 89.), petitioner filed an application for rehearing, which was denied August 28, 1942. (R. 95.)

2. Section 347 of Title 28, U. S. C., provides:

"(a) In any case, civil or criminal, in a Circuit Court of Appeals, * * * it shall be competent for the

Supreme Court of the United States, upon the petition of any party thereto, * * *, to require by certiorari, * * * that the cause be certified to the Supreme Court for determination by it with the same power and authority, and with like effect, as if the cause had been brought there by unrestricted right of error or appeal."

C.

QUESTIONS PRESENTED.

The questions presented are whether petitioner in determining its undistributed profits subject to surtax under Section 14 of the Revenue Act of 1936 was entitled to a credit in amount equal to its adjusted net income for 1936, by reason of the provisions of Section 14(a)(1)(A) and (2) and Section 26(c)(1) of the Revenue Act of 1936, in view of the deficit in petitioner's surplus account at the end of 1935, not removed by 1936 earnings, and the express written provisions, expressly dealing with the payment of dividends, found in petitioner's contracts as follows:

1. Petitioner's indenture dated as of May 1, 1928, but actually executed September 24, 1928, Article 8, Sections 6, 9 and 14 of which are set forth, *supra*, pages 2 and 3. (R. 37.)

2. Petitioner's Certificate of Amendment to its articles of incorporation, dated July 25, 1927 (R. 36), filed in the office of the Secretary of State, State of Ohio, July 29, 1927 (R. 34), sub-paragraphs 1 and 2 of paragraph numbered 5 of which are set forth, *supra*, pages 4 and 5. (R. 35.)

3. Petitioner's stock certificates, dated July 1, 1928 (R. 44, 45), evidencing petitioner's contracts with its shareholders, both preferred and common, which provisions are set forth, *supra*, pages 4 and 5. (R. 44, 49.)

D.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. The decisions of the United States Circuit Court of Appeals and that of the Board of Tax Appeals are probably based upon an erroneous interpretation of and are probably in conflict with the rule of law announced by this Court in *Helvering v. Northwest Steel Rolling Mills, Inc.*, (1940) 311 U. S. 46, and *Crane-Johnson Company v. Helvering*, (1940) 311 U. S. 54.

2. The decision of the United States Circuit Court of Appeals is in direct conflict with the decision of the United States Circuit Court of Appeals for the Third Circuit in the case of *Lehigh Structural Steel Company v. Commissioner* (March 27, 1942), 127 F. 2d 67. The Commissioner of Internal Revenue, respondent herein, filed no petition for writ of certiorari for review of the decision of the Circuit Court of Appeals for the Third Circuit in the *Lehigh Structural Steel Company* case.

3. The precise questions herein involved have never been before this Court, and in view of the decision of this Court in *Helvering v. Northwest Steel Rolling Mills, Inc., supra*, it is submitted that the same are of such general importance that this Court should announce the rules of law properly applicable thereto.

WHEREFORE your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Sixth Circuit, commanding that Court to certify and send to this Court, for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket "No. 9,014, Warren Telephone Company, Appellant and Petitioner Below, v. Commissioner of Internal Revenue, Appellee and

Respondent Below," and that the judgment of the United States Circuit Court of Appeals may be reviewed by this Honorable Court, and your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

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